

THE STATE BAR OF CALIFORNIA
INSURANCE LAW COMMITTEE of the BUSINESS LAW SECTION

APPELLATE LAW UPDATE

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SUPREME COURT: The California Supreme Court published the following opinion of interest to attorneys practicing insurance law.

Under the California Arbitration Act (CAA), parties may agree to expanded judicial review of an arbitration award for legal error where the arbitration agreement expressly requires the arbitrator to act in conformity with the law and provides that the arbitration award is reviewable for legal error. *Cable Connection, Inc. v. DIRECTV, Inc.* (Aug. 25, 2008, S147767) ___ Cal.4th ___, 190 P.3d 586, 82 Cal.Rptr.3d 229

In *Cable Connection*, DIRECTV's sales agency agreement with retail dealers contained an arbitration provision which provided for review by the courts. DIRECTV successfully moved for arbitration. A majority of the 3-member arbitration panel concluded that classwide arbitration was authorized under the arbitration agreement, even though the agreement was silent about class arbitrations. The trial court vacated the award, concluding the panel erred as a matter of law. The Court of Appeal reversed, concluding the trial court erred by reviewing the merits of the arbitrators' decision in the first instance.

The California Supreme Court reversed, concluding that, under the CAA, the parties to an arbitration agreement may agree to judicial review of arbitration awards for legal error. In reaching this conclusion, the California Supreme Court departed from the United States Supreme Court, which, in *Hall Street Associates, L.L.C. v. Mattel, Inc.* (2008) ___ U.S. ___ [128 S.Ct. 1396, 1404-1405], held that the Federal Arbitration Act (FAA) does not permit the parties to agree to expanded judicial review. This seemingly inconsistent result is possible because (a) the United States Supreme Court indicated that that expanded review might be available under state law, and (b) the California Supreme Court concluded that the FAA is not preemptive, and therefore does not require state law to conform to federal law with respect to judicial review of arbitration awards.



COURT OF APPEAL: The California Court of Appeal published decisions in the following four cases that are of interest to attorneys practicing insurance law.

1. **Insurer's decision to maintain high reserves rather than pay billions of dollars in dividends to policyholders is protected by the business judgment rule.** *Hill v. State Farm Mutual Auto. Ins. Co.* (Sept. 19, 2008, B194463) ___ Cal.App.4th ___ [2008 WL 4277389][Second Dist., Div. Three]
2. **Car dealership's "garage operations" policy covers a minor's liability for causing an accident while driving a vehicle purchased for him by his father, regardless how far from the dealership the accident occurred, if the dealership failed to properly transfer ownership. Where the dealership ostensibly sold the vehicle to an adult for the exclusive use of his child, the child was not the dealership's "customer" within meaning of a policy exclusion.** *Spangle v. Farmers Insurance Exchange* (Aug. 29, 2008, B198340) ___ Cal.App.4th ___ [2008 WL 3984391] [Second District, Div. Five]

A dealership sold a vehicle to a man for the exclusive use of his 16-year-old son. The dealership required the father to sign the purchase agreement because it had a policy against entering sales contracts with minors. The son, however, executed the DMV title transfer papers. About a week later, the son turned left into oncoming traffic, causing an accident that severely injured the plaintiff and killed her passenger. The plaintiff made a claim against the dealership's garage liability policy, which the insurer declined on grounds the dealership did not own the vehicle at the time of the accident and because the minor driver was not an insured under the policy due to an exclusion for the dealership's customers. The plaintiff secured a \$3.2 million judgment against the minor. After the insurer rejected a policy limits demand, the plaintiff sued for breach of contract, insurance bad faith and for direct recovery under Insurance Code section 11580. The trial court granted the insurer's motion for summary judgment, ruling that coverage was barred because there was no relationship between the minor's use of the vehicle and the dealership's garage operations.

The Court of Appeal reversed, holding: (1) the garage operations coverage clause did not require any relationship between the use of the vehicle and the dealership's garage operations for coverage to exist for liability arising out the use of an insured vehicle; (2) the exclusion for the dealership's customers did not apply to the son, since only the father was a customer within the meaning of the exclusion; and (3) there was a triable issue of fact regarding whether the dealership retained title to the vehicle so that it would be covered under the policy.



3. **Insurer that fails to cooperate with its insured's coverage investigation is estopped from asserting policy provision requiring insured seeking "functional replacement value" coverage to enter into a contract to repair or replace fire-damaged building within 180 days after the fire.** *City of Hollister v. Monterey Insurance Company* (2008) 165 Cal.App.4th 455 [Sixth District]

A City sought to recover the "functional replacement value" of a fire-damaged building. The policy provided that if the City wished to recover such benefits, it must enter into a contract to repair or replace the building within 180 days after the fire. "Throughout this period, however, [the insurer] refused to confirm that it would honor such a claim, raised spurious grounds for its denial, delayed in communicating basic determinations affecting coverage, refused to disclose its best estimate of the functional replacement value, permitted [the] City to labor under misapprehensions concerning its rights under the policy, and ignored communications from [the] City seeking clarification of these and other matters." As the 180-day deadline neared, the City brought a declaratory relief action against the insurer seeking a determination that the insurer was estopped from asserting the contracting provision in light of its failure to cooperate with the City's efforts to satisfy this condition. The trial court found for City. The Court of Appeal affirmed, holding that the order was within the trial court's broad range of equitable authority.

4. **For purposes of summary judgment, an insurer prosecuting a subrogation action against a party potentially responsible for an insured loss is not bound by its insured's factually devoid interrogatory responses regarding matters that were not within the insured's personal knowledge.** *Great American Insurance Companies v. Gordon Trucking, Inc.* (2008) 165 Cal.App.4th 445 [Fifth District]

NINTH CIRCUIT: The Ninth Circuit Court of Appeals published the following two decisions concerning California insurance law.

- A. **"Flood" exclusion in excess policy unambiguously excludes coverage for loss caused by hurricane storm surge, regardless of the absence of "whether driven by wind or not" language found in the flood definition of a primary policy issued by the same carrier.** *Northrop Grumman Corporation v. Factory Mutual Insurance Company* (9th Cir. 2008) 538 F.3d 1090

Northrop Grumman's shipbuilding facilities on the gulf coast sustained water damage from Hurricane Katrina's storm surge flooding. The loss allegedly exceeded the \$400



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million in flood coverage available under its \$500 million primary layer of coverage. The \$20 billion excess layer excluded coverage for flood, but that exclusion did not contain “whether driven by wind or not” language found in the flood definition in a primary policy issued by the same carrier. The district court ruled that this created an ambiguity, which it construed in favor of coverage.

The Ninth Circuit reversed, holding that the flood exclusion in the excess policy unambiguously applied to hurricane storm surge flooding, regardless of the absence of the “whether driven by wind or not” language found in the primary policy flood definition since the policies were separate contracts. The appellate court remanded for further proceedings regarding the efficient proximate cause issue.

B. Former wife remains the named beneficiary of ex-husband’s life insurance regardless of divorce decree absent express waiver or change of beneficiary. *Life Insurance Company of North America v. Ortiz* (9th Cir. 2008) 535 F.3d 990

Divorce did not extinguish wife’s expectancy interest in husband’s life insurance policy where the text of a property settlement agreement did not clearly state that the wife’s beneficiary status was contemplated and intentionally waived, a document contained a pre-printed notice that such form would not automatically cancel the rights of a spouse as beneficiary, and the husband’s attorney advised him regarding necessity of changing insurance beneficiaries. The district court’s erroneously relied on anecdotal evidence regarding the husband’s post-divorce intent.

